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IN THE

Supreme Court of the United States

OCTOBER TERM, 1952.

No. 780

JOSEPH J. SCHALLERER,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Joseph J. Schallerer, the petitioner, prays that a writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit, entered in the above entitled case on April 1, 1953.

OPINIONS BELOW.

The opinion of the Tax Court of the United States is set forth in full in the record at pages 42-49 and the opinion of the Circuit Court of Appeals is set forth in full in the record of this case at pages 60-68.

JURISDICTION.

The Judgment of the Circuit Court of Appeals was entered on April 1, 1953 (record pages 60-68). The juris-

diction of this Court is invoked under 28 U. S. C. Section 1254.

QUESTIONS PRESENTED.

(1) The Tax Court of the United States and the Circuit Court of Appeals for the Seventh Circuit have failed to rule on the matter of the validity of the trusts A and B herein involved although the matter was adequately presented in the briefs before the court.

(2) The courts below have not considered the special facts presented therein and not in dispute in the determination of the criteria set forth in the case of *Commissioner* v. *Culbertson*, 337 U. S. 733, and further that the criteria set forth in this case is inadequate for the final determination of the case herein involved on the special facts of this case.

STATEMENT.

A brief statement of the facts which are not in dispute is here presented for the convenience of the court.

In 1920 a partnership, known as the Calumet Pattern Works, was organized by the Petitioner and one Wm. J. Flynn, each owning a 50% interest. This partnership relationship and interest continued until the death of Wm. J. Flynn on March 2, 1943. The partners organized in 1930 a trust with the Chicago Title & Trust Co. as trustee, the terms of which were briefly to the effect that the surviving partner have a right to purchase the interest of the deceased partner and that the proceeds from insurance on the life of the deceased partner be applied against the purchase price. Wm. J. Flynn died on March 2, 1943.

The surviving partner, the petitioner herein, agreed with the estate of Wm. J. Flynn that the deceased partner's in-

terest be turned over to Two Trusts, known as the Joseph J. Schallerer Trust A and Trust B and that the estate of the deceased partner be compensated for this transfer by the payment to the estate of the proceeds of the insurance and the balance of the price was paid by the continuing business from its future profits. The Petitioner paid nothing for the interest of the deceased partner and the trusts were the new owners of the assets of the interest of Wm. J. Flynn. It must be stated at this point that the Trusts also obtained an additional 5% of the interest of the Petitioner so that on March 12, 1943, when the trusts were organized the trusts were the owners of a 55% interest in the assets of the Calumet Pattern Works and the Petitioner was the owner of 45% interest in the assets of the business, whereas prior to the death of Wm. J. Flynn the partners each owned a 50% interest. In fact the Petitioner had not only paid nothing for the transfer of the interest to the Estate of Wm. J. Flynn *but* had obtained valuable assets from the business as his own property.

The Petitioner will now cut off the facts at this point and call the attention of the court to QUESTION No. 1 presented to the court as no further facts are necessary for the decision on this question. This is for the convenience of the court so that the argument as to this question may be presented elsewhere in this petition.

On March 19, 1943, *as an operating measure,* the Petitioner and the Two Trusts entered into a partnership agreement. The Tax Court of the United States and the Circuit Court of Appeals in the Seventh Circuit based their opinion on the question as to whether there was a valid partnership between the Petitioner and the Two Trusts under the code, *but failed to rule* on the question as to whether the Two Trusts were valid trusts under the Internal Revenue Code *separate and apart* from the partner-

ship question. The argument in this petition as to the partnership question is set forth in QUESTION No. 2 presented in this petition.

The Tax Court of the United States in its opinion set forth in the record at pages 42-49, decided the QUESTION No. 2 *but failed to rule* on the subject matter of QUESTION No. 1. The cause was then appealed to Circuit Court of Appeals in the Seventh Circuit and the decision of this Court is set forth in the record at pages 60-68. The Tax Court of the United States held that the income from the entire business was taxable under the Internal Revenue Code, to the Petitioner on the grounds that the partnership herein involved was not a true partnership, *but failed* to pass on the validity of the Two Trusts organized on March 12, 1943. On appeal to the Circuit Court of Appeals for the Seventh Circuit, that court also held that there was no valid partnership under the Internal Revenue Code, affirming the decision of the lower court and that court also failed to decide the question as to the validity of the trusts as will be pointed out later in this petition. The Petitioner will set forth *Two* separate points as to why this Court should grant certiorari.

REASONS FOR GRANTING THE WRIT.

QUESTION No. 1. The question as to the validity of the two trusts known as the Joseph J. Schallerer Trust A and B was not decided by either of the lower courts although the brief of the Petitioner before the Circuit Court of Appeals dealt with the question extensively. Referring to the statement of the facts and stopping at the point indicated therein before the organization of the partnership and assuming that no partnership had in fact been organized, then the court would have been required to determine the validity of the trusts. The fact that the trust *res* con-

sisted of personal property out of which arose an operating profit does not require that there be an express or implied partnership and the trusts stand independently as the owner of the property. If the trust *res* were a building or an oil well, either of which might result in income from operation, it does not mean that the court would be required to read into the operation an express or implied partnership, then determine the validity of the express or implied partnership under the code and if such partnership is not valid under the code, the court would deem it unnecessary to determine and rule as to the validity of the trusts. The trusts stand independently as the owner of their share of the assets and the fact that the beneficiaries of the trusts were members of the donor's family would simply be one of the many facts which may make the trust valid or invalid, *but* that point should be decided by the appeal court otherwise the Petitioner *has not had a proper review.* The Circuit Court of Appeals decided the validity of the partnership and as to the trusts makes the following statement (record page 67):

> "Taxpayer urges that the trusts were valid trusts and that their income is not taxable to him. Since no bona fide partnership existed within the purview of the taxing statute and since the business income was found to be taxable to the taxpayer, there was no income taxable to the trusts as partners. See *Feldman* v. *Commissioner,* 186 F. 2d 87. The trusts had no other income than that accumulated and reserved for distribution by the alleged partnership."

In this statement the court assumes that if the partnership was invalid then the trusts had no income. However, if the court had no partnership before it, or since it declared that the partnership was invalid and therefore under the code there was no valid partnership, then the court still had before it the trusts who were the legal owner of the property. The income of the trusts was *not*

obtained as a result of the provisions of the partnership, *but* as a result of the ownership of the property and the trust provisions as set forth in the trust instrument. The trust instrument required that the income be accumulated for the benefit of the beneficiaries. The partnership was an operating partnership and if it had never been written and the business was operated as a corporate enterprise the courts would not have considered the owner of 55% of the stock outstanding in partnership with the owner of the 45% interest. The only question before the court then would have been the question as to the validity of the trusts under the code. There is no warrant in the Internal Revenue Code or in the decisions of the courts including the case of *Feldman* v. *Commissioner,* 186 F. 2nd 87, cited by the court below for making any distinction as to the type of property owned by the trusts. In such case the only question was the validity of the trusts and the rule in *Helvering* v. *Clifford,* 309 U. S. 331, and *Commissioner* v. *Branch,* 114 F. 2nd 985 (C. C. A., 1st), together with many other cases on the subject decided by this Court and are the only criteria to be used and these cases were cited and argued by the Petitioner in the court below. This fact was extensively set forth in the brief of the Petitioner filed in the lower court and not considered by that court.

The court below cites the case of *Feldman* v. *Commissioner,* 186 F. 2nd 87, and the Petitioner has read this case but finds that nowhere in the report of that case is there a reference to the question as to the validity of the trusts. It was not decided in that case and the only question there decided was the validity of the partnership. The trusts are the owner of the property and the income resulting from such ownership is accrued to the owner. *Blair* v. *Commissioner,* 300 U. S. 5 (1937). Is the actuality of ownership of real or personal property to be discarded and a distinction made between types of personal prop-

erty such as stocks and bonds (so-called investments) and property directly operated as a profitable business or an individual investment in a building owned jointly by two or more interests? The courts may look into the reality of the ownership under the code in the same manner as it looks to the reality of a partnership, but once having determined that the ownership was complete the new owner is the owner of the income from the property. The fact that the beneficiaries of the trusts are members of the family of the donor is merely one of the factors to be considered by the court in determining the validity of the trusts under the code.

The Bench and Bar are entitled to have a matter of such importance clarified by this Court and this question is one of the reasons there is before this Court the request of the Petitioner for the granting of the writ.

QUESTION No. 2. The second question involved herein is the fact that the case before this Court involves certain facts quite different from the facts in *Commissioner* v. *Tower*, 327 U. S. 280, *Lusthaus* v. *Commissioner*, 327 U. S. 293, and *Commissioner* v. *Culbertson*, 337 U. S. 733. Your Petitioner therefore prays that this Court, due to the difference in facts which will hereafter be set out, clarify and modify the decision in *Commissioner* v. *Culbertson*, 337 U. S. 733.

Examination of the facts in the above mentioned cases, all are clear to the effect that the taxpayer was the owner of a certain interest in a going business and that in each case the taxpayer *split up his interest* among members of his family. That seems to be characteristic of all family partnership cases *except in the case before this Court.*

The taxpayer herein on March 2, 1943, owned a 50% interest in a going business and one Wm. J. Flynn owned the other 50% interest. Now if the taxpayer had split

up his 50% interest among his family then there would have been an exact similarity with the family partnership cases. To the extent of 5% the Petitioner did split up his own interest leaving the Petitioner with a 45% interest and this 5% was turned over to Trust B. But, other than this 5%, there was no split up of the interest owned by the Petitioner. Wm. J. Flynn died on March 2, 1943, and the question arose as to what to do with his interest. The Petitioner did not intend that this situation happen nor did the Petitioner plan to reduce his taxes. The government is attempting to increase the taxes of the Petitioner because of this unforeseen circumstance.

The Petitioner and the estate of Flynn made a deal and this was a strictly business deal and at arm's length. The value of Flynn's interest was set at $54,915.13 (that being one-half of the entire value of the business). This interest was transferred to the Trusts, 45% to Trust A and 5% to Trust B (Trust B also had an additional 5% obtained from the Petitioner's own holding). The estate was paid the insurance on the life of Flynn in the amount of $11,415.13 and the balance of $43,500.00 was paid by the continuing business out of its assets and future profits. Nothing was paid out of the pocket of the Petitioner. *In fact,* the Petitioner benefited from the deal in that the real estate owned by the business of a value of $32,082.04 was transferred to the Petitioner as his own property. The actual value as a going concern of this real estate was far greater.

There is no question that the trusts acquired the 50% owned by the estate of Flynn (see record page 29), there is no question that the Petitioner paid nothing out of his own pocket for this transfer and there is no question that the estate of Flynn was paid from the insurance money and from the assets of the going business. All of this was effective on March 3, 1943. The difference in the facts is

material and the bench and bar are entitled to a clarification of the criteria set forth in the case of *Commissioner* v. *Culbertson,* 337 U. S. 733. The courts below refused to rule directly on this point although it was pointed out but ignored the difference in the facts. The Petitioner faced with the death of his partner entered into a reasonable deal with the estate of Flynn, with no intention of *reducing his taxes* (as before the death of Flynn he paid a tax on 50% interest and after Flynn's death paid a tax on 45% of the income of the business) except as to the 5% BUT the government by a claim that the deal involved a so-called family partnership case is now attempting to *increase* the taxes of the Petitioner over what it was prior to his partner's death, because of the death of his partner. Such circumstances should take the case out of the rule in the case of *Commissioner* v. *Culbertson,* 337 U. S. 733.

The trusts did not put into the business *new* capital as the capital of an outside interest (Flynn's) was already there and the trusts were not taking over any capital of the family group (excluding the 5% previously stated). The most that can be said of the deal is that the Petitioner in an at arm's length transaction with the estate of Flynn, was the conduit through which the interest flowed to the trusts. It might also be said that, in view of the fact that the continuing business paid the Estate of Flynn out of the future profits of the business then the Petitioner paid to the extent of his share of the profits (45%). This was offset by the acquisition of the building by the Petitioner so that even taking this view the Petitioner paid nothing.

The legal criteria of the case of *Commissioner* v. *Culbertson,* 337 U. S. 733, is not clear to the Petitioner and to many members of the bench and bar and the members of the bar are at a loss to say just what the necessary criteria are in a family partnership case and the members of the Tax Court of the United States seem also to be in a

dilemma as to the exact rules to be applied. In the opinion of the Tax Court of the United States (page 47 of the record) the court states as follows:

> "Petitioner's contention is that since he created two *valid* trusts, and since a trust may legally enter into a partnership agreement, the income allocable to the capital contributions by the trusts may not be taxed to him. *Theodore D. Stern,* 15 T. C. 521. We think the issue may not be so limited and involves a factual determination of whether, in the light of all the facts and circumstances, the parties, in good faith and acting with a business purpose, intended to join together in the conduct of a business partnership. *Commissioner* v. *Culbertson,* 337 U. S. 733."

It might be said at this point that when the case was tried by the Tax Court by the Hon. Judge Leech (now deceased) the court at the conclusion of the hearing called to the bench both counsel for the Petitioner and the government and made the statement in open court to the effect that Judge Murdock, another member of the court, was at that time ready to render a decision in a case with identical facts to the case now at issue. Judge Leech died and Judge Murdock rendered his decision and the Tax Court by a divided court, with five members dissenting, decided in favor of the validity of the partnership in *In re Theodore Stern,* 15 T. C. 521. Judge Le Mire, after the death of Judge Leech rendered the opinion and held that the partnership herein involved was not valid. The criteria may be there but such a diversity of opinion is possible on the same state of fact that it is a necessity for this Court to make more definite and spell out more definitely what the criteria are, especially when there is sufficient variance in the facts. The Petitioner prays that the court grant the writ and clear up a definite mis-understanding not only as to the criteria involved in the case of *Commissioner* v. *Culbertson,* 337 U. S. 733, but determined the question

raised in QUESTION No. 1 discussed elsewhere in this petition.

The Petitioner further wishes to point out that the record before this Court and the statements and opinion of the court shows that the court below did not fully consider *all of the facts* disclosed by the record.

It was pointed out in the court below that when the Board Member who conducted the hearing (the same is true of the member of the court due to the change of name) died before rendering a decision and the case was decided by the Board (now Court) on the stenographic record, the courts hold that the weight of the Board's (now Court's) finding was lessened because no member who decided the case had seen the witnesses. *Foss* v. *Commissioner*, 75 F. 2nd 326 (C. C., 1st).

It was pointed out by the Petitioner in the court below in his brief as follows:

> "The Petitioner wishes to point out that the statement of the facts in the opinion of the court below (printed record pages 42 to 49) does not give a *complete view of all of the facts presented in the record.*"

The record before this Court includes the testimony of the Petitioner to the effect that the interest of the deceased partner was transferred to the Trusts A and B (record page 29), the Hon. Judge Leech heard this testimony and ruled on it yet the Hon. Judge Le Mire who did not hear the testimony and decided the case on the stenographic notes did not consider any of this evidence in his statement of fact. Judge Le Mire ignored this testimony. Where it is necessary to determine the *intent* of the petitioner then the court who hears the case should render the judgment and if another judge renders the judgment then he is in no position to determine the intent by merely reading the stenographic notes. The court below should

have considered this question but did not do so in its statement of facts or in its opinion. It was pointed out to the court below that it is reversible error for the Board of Tax Appeals, now the Tax Court, to disregard competent and relevant testimony *not contradicted* and further that the Court of Appeals, when such a condition is brought to its attention, should consider and rule on this condition otherwise the Petitioner would not have a *complete review* of his contentions in the appeal court.

Your Petitioner prays that this Court consider the fact of this omission of competent evidence and the fact that the intention of the Petitioner was determined by the Tax Court not from the personal observation of the testimony of the Petitioner but second hand by the reading of the record and that the determination of intent on the part of the Petitioner by the judge of the Tax Court is not such as to make it a real determination of intent.

CONCLUSION.

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

ISAAC I. BENDER,
Counsel for the Petitioner.

Dated: May 1, 1953.

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In the Supreme Court of the United States

OCTOBER TERM, 1952

No. 780

JOSEPH J. SCHALLERER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 42–49) are unreported. The opinion of the Court of Appeals (R. 60–67) is reported at 203 F. 2d 100.

JURISDICTION

The judgment of the Court of Appeals was entered on April 1, 1953 (R. 68). The petition for a writ of certiorari was filed on May 4, 1953. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

The ultimate question is whether the Court of Appeals was correct in holding that the Tax Court, on the whole record, was warranted in concluding

that the taxpayer and two trusts created by him for the primary benefit of his wife and daughter were not engaged in conducting a business as partners during the taxable years, and in concluding that the business income was earned by and was taxable to the taxpayer.

STATUTE AND REGULATIONS INVOLVED

The applicable provisions of the statute and regulations involved appear in the Appendix, *infra*, pp. 14–15.

STATEMENT

The facts, as found by the Tax Court, may be summarized as follows:

During the taxable years, the taxpayer was living with his wife, Anna J. Schallerer, and his only child, Grace E. Schallerer. The taxpayer and his wife were each 63 years old and the daughter was 36 years old (R. 43).

In 1920, the taxpayer and William J. Flynn had entered into a partnership engaged in the manufacture of patterns for the iron and steel industry. The business was conducted under the name of Calumet Pattern Works. Both partners performed personal services for the business, and the profits and losses were divided equally. In 1930, they entered into an agreement with the Chicago Title and Trust Company, as trustee. The partnership had insured the life of each partner and had designated the trustee as beneficiary. Their agreement provided that on the death of a partner the survivor was entitled to acquire the decedent's interest at book value, except

that items appearing on the books at cost should be valued at market value. It was further provided that the proceeds of the insurance policy should be paid to the decedent's estate and applied against the purchase price (R. 43–44).

William J. Flynn died on March 3, 1943. Within a week taxpayer agreed with Flynn's widow to purchase the partnership assets at an agreed price of $54,915.13 and to convey to her two vacant lots having a total book value of $3,382.40. The formal agreement, executed on June 15, 1943, provided that the $54,915.13 was to be paid as follows: $3,500 advanced to pay the March 15 installment of personal income tax of decedent; $3,456.09 to pay the June 15, installment; $11,543.91 in cash; $5,000 in United States Treasury notes and $20,000 in notes to the Chicago Title and Trust Company as trustee for the Flynn estate. The balance was by credit of the $11,415.13 received by the trustee as the proceeds of the insurance policy on Flynn's life (R. 44).

In payment of the above amounts, taxpayer immediately turned over to Flynn's estate, out of the assets of the dissolved partnership, the following assets: $5,000 in Treasury notes; check of dissolved partnership for $5,758.28; and cash of $3,500 to pay Flynn's March 15, 1943, income tax installment. Taxpayer then obligated the new business, conducted as Calumet Pattern Works, for the amount of $29,241.72 (R. 44).

Taxpayer personally withdrew from the assets of the dissolved partnership certain land and a build-

ing erected in 1940, having a depreciated book value as of March 2, 1943, of $32,082.04 (R. 44).

The balance sheet of the new business conducted as Calumet Pattern Works, as shown by book entries as of March 3, 1943, was as follows (R. 44–45):

Assets:			
Cash		$38,032.35	
Accounts receivable		2,240.00	
Notes receivable		1,362.02	
Inventory		4,000.10	
U. S. Treasury tax notes		5,000.00	
Stocks and real estate		5,072.12	
Machinery and equipment (net)		1,758.92	
Truck (net)		479.16	
Total Assets			$57,944.67
Liabilities:			
Accounts payable and accruals	$1,720.94		
Mrs. Wm. J. Flynn	29,241.72		
Total Liabilities		$30,962.66	
Capital Accounts:			
Joseph J. Schallerer	$12,141.91		
Charles Murphy, et al. Trustees of Trust "A"	12,141.90		
Trust "B"	2,698.20		
Total Capital		26,982.01	
Total Liabilities and Capital Accounts			$57,944.67

On March 12, 1943, taxpayer executed two separate trusts designated "A" and "B." The primary beneficiary in Trust "A" was his wife, and in "B," his daughter. Charles Murphy was named a trustee with the daughter in Trust "A", and with the wife in Trust "B," Taxpayer transferred to Trust "A" an undivided 45/100 interest in the assets of the Calumet Pattern Works (except real estate and chattels real), and to Trust "B" a 10/100 undivided interest.

The trustees were given broad powers, including the power to carry on the business enterprise of which the trust corpus was a part, either alone or as a copartner with any other person or corporation. The balance of the trust income, after taxes and administrative expenses, was to be paid to the beneficiaries in quarterly installments, except that the first installment was not to become due and payable before three months after the income of the five preceding calendar years had been ascertained. In the event the beneficiary predeceased the taxpayer, the corpus, but not the undistributed income, was to immediately revert to the taxpayer. The corpus and undistributed income of Trust "A," upon the death of taxpayer, was to be divided into as many portions as there were years in the life expectancy of Anna J. Schallerer at that time. One portion, together with the income of the trust estate, was to be distributed to the wife annually during her life, and upon her death to taxpayer's daughter or her issue. The corpus and undistributed income of Trust "B," upon the death of taxpayer, was to be divided into 240 shares. One share, together with the income, was to be distributed to the daughter, the undistributed balance was to go as appointed in her will and, in default of appointment, to her issue then 21 years of age, or accumulated until such issue reached the age of 21. In the event of no issue surviving, then the property was to go to taxpayer's wife, if living, and if deceased, to the taxpayer's then heirs-at-law. Each trust contained a spendthrift clause. Each of the trusts could be

terminated by the primary beneficiary with the consent of the trustees, and in that case the entire corpus and undistributed income would go to the beneficiary immediately (R. 45–46).

A partnership agreement dated March 19, 1943, was executed by taxpayer and the respective trustees of Trust "A" and Trust "B", to commence on that date and to continue for a period of ten years unless sooner dissolved. It recited that the parties were the sole owners of the Calumet Pattern Works, with undivided interests as follows: taxpayer, 45 percent; Trust "A," 45 percent; and Trust "B," 10 percent (R. 46).

The agreement provided that the profits and losses should be shared in proportion to the capital contribution of each partner, and that a reasonable salary should be paid to each active partner (R. 46–47).

Taxpayer, during the taxable years, had complete management of the business. Between 38 and 40 skilled pattern makers were employed who received annual salaries, with overtime, of approximately $5,000 each. Taxpayer drew no salary. Taxpayer's daughter, Grace, continued to be employed in the business. She was paid as an ordinary employee and her salary was not considered in any way in computing the income to which Trust "B" was entitled. Trustees Charles Murphy, an insurance man, and Anna J. Schallerer, taxpayer's wife, performed no services for the Calumet Pattern Works and received no salary from the business (R. 47).

Partnership returns were filed on the basis of a fiscal year ended February 28, showing the respective distributable share of each partner. In determining the deficiencies, the Commissioner taxed all the income of the Calumet Pattern Works, adjusted to a calendar year basis, to taxpayer (R. 47).

On the basis of all the facts, the Tax Court concluded that (R. 47): "During the taxable years, petitioner [taxpayer] and the trustees of Trusts 'A' and 'B,' or the primary beneficiaries thereof, did not really and truly intend, in good faith, to join together in carrying on the business of Calumet Pattern Works as partners" and upheld the Commissioner's deficiency determinations (R. 48). The Court of Appeals affirmed (R. 60–67).

ARGUMENT

1. In deciding that the business income in controversy should be taxed to the taxpayer because it was earned by him, personally, and not by a family partnership composed of himself and two trusts which he had established for his wife and daughter, the Tax Court and the Court of Appeals correctly applied the principles announced in *Commissioner* v. *Tower*, 327 U. S. 280; *Lusthaus* v. *Commissioner*, 327 U. S. 293; and *Commissioner* v. *Culbertson*, 337 U. S. 733. The ultimate test is "whether, considering all the facts * * * the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise." *Commissioner* v. *Culbertson*, *supra*, p. 742.

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The evidence fully supports the Tax Court's conclusion that there was no partnership enterprise of the kind where the business income is genuinely earned by all the partners. The partnership which the taxpayer created was not intended to and did not in fact have any business purpose germane to the present conduct of a partnership to be engaged in the pattern making business. The only purpose which motivated the taxpayer in making this family arrangement was his desire to insure that the business would continue to be operated after his death and that his family would possess a controlling interest at that time (R. 33–34, 37). This, as the Tax Court (R. 48), and the Court of Appeals (R. 65) noted, negated an intention to conduct the business as a partnership during the taxpayer's lifetime.

The lack of an intention to join together as partners in the present conduct of a business is also evident from the fact, which is undisputed, that neither the beneficiaries nor the third-party trustee was expected to or did perform any vital services in carrying on the business. Nor did they exercise any control over the affairs of the business by participating in its management (R. 47–48, 67). The only vital services performed by the alleged partners were those contributed by the taxpayer who, although he received no salary, managed the business and did all the work which would normally be performed by a sole proprietor. The income from the business, it is important to observe, was largely attributable to the

personal services and management performed by the taxpayer, and capital was only of minor importance.[1]

The capital which was used in the business was furnished by the taxpayer and none of it originated with the trusts which the taxpayer claims were business partners, or with the beneficiaries of the trusts.[2] By his complete management and control over the business and its assets, the taxpayer continued to exercise full dominion over the business property notwithstanding (*Commissioner* v. *Culbert-*

[1] While the balance sheet (R. 45) shows that the business had assets of approximately $58,000, more than $43,000 was represented by cash and United States Treasury Notes. Thus, with only $15,000 of assets actually devoted to the business, more than $60,000 of income was earned in the first year of the alleged partnership (Pet. Ex. 13).

[2] While the taxpayer seems to contend (Pet. 7–11) that the interest in the assets of the business conveyed to the two trusts created by the taxpayer did not originate with him, the uncontradicted evidence is to the contrary. The taxpayer, upon the death of his former partner, became entitled to purchase the assets, to continue the business and to have the proceeds of the insurance policy on the life of his deceased partner applied toward the purchase price. He acquired the assets by agreeing, *as an individual*, to pay the balance of the purchase price; part of the payment was made immediately and the rest was paid in 1943 out of the operations of the business (Pet. Exs. 6 and 12).

Consequently, whatever interest in the assets was acquired by the two trusts of necessity came from the taxpayer, and the trust instruments recite what is plainly true, namely, that the interest in the business assets was conveyed to the two trusts by the taxpayer (Pet. Exs. 7 and 8). Since the trusts possessed no other assets, it is impossible to comprehend how they could have acquired this interest in the business assets except from the taxpayer. The Court of Appeals correctly stated (R. 65)—"The two trusts invested in the business only what was given them by the taxpayer."

son, 337 U. S. 733, 746) the "surface changes of ownership." In addition, the fact that there was no distribution of partnership income during the taxable years (except a sufficient amount to permit the trusts to pay income taxes) either to the trusts or to the beneficiaries (Pet. Ex. 12 and 13), demonstrates that the taxpayer's ownership of and control over the business and its income was unaffected by the paper reallocation within the family group.

In the *Culbertson* case, this Court (at p. 744) pointed out that where the alleged family partners do not contribute original capital, do not perform vital services, and do not participate in the management or control of the business, there is "a heavy burden on the taxpayer to show the bona fide intent of the parties to join together as partners." The taxpayer here, far from meeting this heavy burden, points to nothing in the record which would tend to demonstrate that the parties did intend to join together to conduct the business as genuine partners. On the contrary, as has been shown, all the evidence is consistent with the Tax Court's conclusion that they did not do so and that it was the taxpayer who earned all the income. Since it was the taxpayer who earned the income by his services, his management, and his dominion over the business assets, well settled principles require that the income be taxed to him in its entirety. And under those principles, he is not permitted to avoid the full impact of the tax by any anticipatory assignment of that income within the family group. *Lucas* v. *Earl*, 281 U. S. 111; *Hel-*

vering v. *Clifford*, 309 U. S. 331; *Helvering* v. *Horst*, 311 U. S. 112; *Helvering* v. *Eubank*, 311 U. S. 122; *Harrison* v. *Schaffner*, 312 U. S. 579; *Commissioner* v. *Tower*, 327 U. S. 280; *Lusthaus* v. *Commissioner*, 327 U. S. 293; *Commissioner* v. *Sunnen*, 333 U. S. 591; *Commissioner* v. *Culbertson*, 337 U. S. 733.

2. The taxpayer complains (Pet. 4–7) that the courts below erred in failing to pass on "the validity of the two trusts * * *." However, the question whether, if the trusts had possessed other sources of income, such income would have been taxable to the taxpayer, as grantor, under the principles of *Helvering* v. *Clifford*, 309 U. S. 331, or would have been taxable to the trusts, is an academic one and the lower courts properly refrained from expressing an opinion upon it. Since the income in question was earned by the taxpayer and not by the alleged partnership, the income was not properly taxable to the trusts and it was taxable to the taxpayer. As this Court stated in the *Culbertson* case (pp. 739–740), to tax the income to "persons who contribute nothing during the tax period would violate the first principle of income taxation: that income must be taxed to him who earns it."

The taxpayer could no more insulate himself from tax liability on his personal income by creating trusts as partners than if he had attempted to enter into a similar partnership with his wife and daughter as individuals. *Stanton* v. *Commissioner*, 189 F. 2d 297 (C. A. 7); *Morano* v. *Commissioner*, 175 F. 2d 555 (C. A. 3), certiorari denied, 338 U. S. 904; *Eisenberg*

v. *Commissioner*, 161 F. 2d 506 (C. A. 3), certiorari denied, 332 U. S. 767; *Feldman* v. *Commissioner*, 186 F. 2d 87 (C. A. 4); *Stanback* v. *Robertson*, 183 F. 2d 889 (C. A. 4); *Economos* v. *Commissioner*, 167 F. 2d 165 (C. A. 4), certiorari denied, 335 U. S. 826; *Hash* v. *Commissioner*, 152 F. 2d 722 (C. A. 4), certiorari denied, 328 U. S. 838; *Belcher* v. *Commissioner*, 162 F. 2d 974 (C. A. 5), certiorari denied, 332 U. S. 824; *Benson* v. *Commissioner*, 161 F. 2d 821 (C. A. 5); *Dawson* v. *Commissioner*, 163 F. 2d 664 (C. A. 6); *Kohl* v. *Commissioner*, 170 F. 2d 531 (C. A. 8), certiorari denied, 337 U. S. 956; *Quon* v. *Commissioner* 165 F. 2d 215 (C. A. 9), certiorari denied, 334 U. S. 845; *Losh* v. *Commissioner*, 145 F. 2d 456 (C. A. 10).

The court below, accordingly, correctly answered this contention of the taxpayer by stating (R. 67):

> Since no bona fide partnership existed within the purview of the taxing statute and since the business income was found to be taxable to the taxpayer, there was no income taxable to the trusts as partners. See *Feldman* v. *Commissioner*, 186 F. 2d 87. The trusts had no other income than that accumulated and reserved for distribution by the alleged partnership.

CONCLUSION

The decision of the court below is correct and further review is not warranted. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APPENDIX

Internal Revenue Code:

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a * * * tax * * *.

(26 U.S.C. 1946 ed., Sec. 11.)

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U.S.C. 1946 ed., Sec. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U.S.C. 1946 ed., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b).

(26 U.S.C. 1946 ed., Sec. 182).

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

(26 U.S.C. 1946 ed., Sec. 3797.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

Sec. 29.22(a)–1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22(b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, * * *.

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